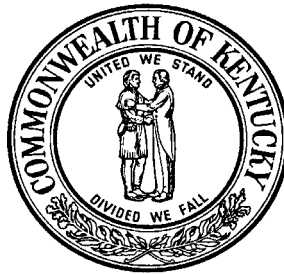


**LETTER FROM THE AUDITOR OF PUBLIC ACCOUNTS
CABINET FOR WORKFORCE DEVELOPMENT**

**In Reference to the Statewide Single Audit
of the Commonwealth of Kentucky**

For the Year Ended June 30, 2003



**CRIT LUALLEN
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TABLE OF CONTENTS

MANAGEMENT LETTER.....	1
MANAGEMENT LETTER.....	3
LIST OF ABBREVIATIONS/ACRONYMS.....	5
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS	7
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS	9
FINANCIAL STATEMENT FINDINGS	12
<i>Reportable Conditions Relating to Internal Controls and/or</i> <i>Reportable Instances of Noncompliance</i>	<i>12</i>
FINDING 03-CWD-1: The Division Of Unemployment Insurance Should Perform Reconciliation Of Tax Payments Received By Kentucky Revenue Cabinet To Its Mainframe Program	12
FINDING 03-CWD-2: The Division Of Unemployment Insurance Should Enhance Controls To Ensure Proper Reporting Of The Closing Package.....	14
FINDING 03-CWD-3: The Cabinet For Workforce Development Should Strengthen The Security Of Administrator Accounts.....	17
FINANCIAL STATEMENT FINDINGS	18
<i>Other Matters Relating to Internal Controls and/or Instances of Noncompliance</i>	<i>18</i>
FINDING 03-CWD-4: The Division Of Unemployment Insurance Should Strengthen Controls Over The Preparation Of Accounting Estimates.....	18
FINDING 03-CWD-5: The Division Of Unemployment Insurance Should Implement Controls To Ensure That All Transactions Have Proper Authorization And Adequate Documentation	20
FINDING 03-CWD-6: The Cabinet For Workforce Development Should Ensure That Security Information Leakage Concerning Agency Devices Is Minimized	22
FINDING 03-CWD-7: The Cabinet For Workforce Development Should Ensure That All Open Ports On Agency Machines Have A Business-Related Purpose.....	24
FINDING 03-CWD-8: The Cabinet For Workforce Development Should Ensure All User Accounts On Its Agency Machines Are Necessary	26
FINDING 03-CWD-9: The Cabinet For Workforce Development Password Policy Should Be Consistently Applied To All Local Area Network Machines	27
FEDERAL AWARD FINDINGS AND QUESTIONED COSTS	29
<i>Reportable Conditions Relating to Internal Control and/or</i> <i>Reportable Instances of Noncompliance</i>	<i>29</i>
FINDING 03-CWD-10: The Department For Training And ReEmployment Should Implement Controls Over Monitoring Procedures to Ensure Compliance	29
FINDING 03-CWD-11: The Department For Training And ReEmployment Should Implement Formal Procedures to Ensure Accurate Federal Reporting.....	32

TABLE OF CONTENTS

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS	34
<i>Other Matters Relating to Internal Controls and/or Instances of Noncompliance</i>	34
FINDING 03-CWD-12: The Division Of Unemployment Insurance Should Implement Procedures To Ensure Timely Submission Of The Internal Revenue Service 940 Federal Unemployment Tax Administration Certification	34
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS	35



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

Virginia Fox, Secretary, Education Cabinet
Cabinet for Workforce Development

MANAGEMENT LETTER

Pursuant to KRS 43.090 (1), which states, "[i]mmediately upon completion of each audit and investigation, except those provided for in KRS 43.070, the Auditor shall prepare a report of his findings and recommendations," we are providing this letter to the Cabinet for Workforce Development to comply with KRS 43.090.

This letter presents the results of the work performed at the Cabinet for Workforce Development, as part of our annual audit of the Commonwealth of Kentucky's financial statements.

In planning and performing our audit of the basic financial statements of the Commonwealth for the year ended June 30, 2003, we considered the Cabinet for Workforce Development's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control. However, we noted certain matters involving the internal control and its operation that we considered to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the Cabinet for Workforce Development's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily disclose all matters that might be reportable conditions. In addition, because of inherent limitations in internal control, errors or fraud may occur and not be detected by such controls

As part of our audit of the Commonwealth's basic financial statements, we also performed tests of the Cabinet for Workforce Development's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. The results of those tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.



Virginia Fox, Secretary, Education Cabinet
Cabinet for Workforce Development

Some findings are Other Matters that we have included in this letter to communicate with management in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*.

Included in this letter are the following:

- ◆ Acronym List
- ◆ Findings and Recommendations
(Reportable Conditions, Noncompliance, and Other Matters)
- ◆ Summary Schedule of Prior Year Audit Findings

We have issued our Statewide Single Audit of the Commonwealth of Kentucky that contains the Cabinet for Workforce Development's findings, as well as those of other agencies of the Commonwealth. This report can be viewed on our website at www.kyauditor.net.

This letter is intended solely for the information and use of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a stylized flourish at the end.

Crit Luallen
Auditor of Public Accounts



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

Virginia Fox, Secretary, Education Cabinet
Cabinet for Workforce Development

MANAGEMENT LETTER

Pursuant to KRS 43.090 (1), which states, "[i]mmediately upon completion of each audit and investigation, except those provided for in KRS 43.070, the Auditor shall prepare a report of his findings and recommendations," we are providing this letter to the Cabinet for Workforce Development to comply with KRS 43.090.

This letter presents the results of the work performed at the Cabinet for Workforce Development, as part of our annual Statewide Single Audit of the Commonwealth of Kentucky.

In planning and performing our audit over compliance with requirements applicable to major federal programs, for the year ended June 30, 2003, we considered the Cabinet for Workforce Development's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on compliance with requirements applicable to each major federal program and to report on internal control over compliance in accordance with Office of Management and Budget (OMB) Circular A-133 and on the Schedule of Expenditure of Federal Awards (SEFA).

We noted certain instances of noncompliance with requirements applicable to major federal programs we considered to be reportable under standards established by OMB Circular A-133.

We noted certain matters involving internal control over compliance and its operation that we considered to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over compliance that, in our judgment, could adversely affect the Cabinet for Workforce Development's ability to administer a major federal program in accordance with the applicable requirements of OMB Circular A-133.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily disclose all matters that might be reportable conditions.

In addition, because of inherent limitations in internal control, errors or fraud may occur and not be detected by such controls.



Virginia Fox, Secretary, Education Cabinet
Cabinet for Workforce Development

As part of our audit of the Commonwealth's basic financial statements, we also performed tests of the Cabinet for Workforce Development's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. The results of those tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Some findings are Other Matters that we have included in this letter to communicate with management in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*.

Included in this letter are the following:

- ◆ Acronym List
- ◆ Schedule of Expenditures of Federal Awards
- ◆ Notes to the Schedule of Expenditures of Federal Awards
- ◆ Findings and Recommendations
(Federal Noncompliance, Reportable Conditions, Noncompliance, and Other Matters)
- ◆ Summary Schedule of Prior Year Audit Findings

We have issued our Statewide Single Audit of the Commonwealth of Kentucky that contains the Cabinet for Workforce Development's findings, as well as those of other agencies of the Commonwealth. This report can be viewed on our website at www.kyauditor.net.

This letter is intended solely for the information and use of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,



Crit Luallen
Auditor of Public Accounts

LIST OF ABBREVIATIONS/ACRONYMS

ADD	Area Development District
AFR	Annual Financial Report
BADD	Bluegrass Area Development District
BDC	Backup Domain Controllers
CFR	Code of Federal Regulations
CFDA	Catalog of Federal Domestic Assistance
CWD	Cabinet for Workforce Development
CIM	Compaq Insight Manager
CIO	Chief Information Officer
DLN	Document Locator Number
DOL	Department of Labor
DTR	Department for Training and ReEmployment
ETA	Employment and Training Administration
FAC	Finance and Administration Cabinet
FSR	Financial Status Reports
FTP	File Transfer Protocol
FUTA	Federal Unemployment Tax Administration
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GOT	Governor's Office for Technology
ID	Identification
IRS	Internal Revenue Service
JTPA	Job Training Partnership Act
KEIN	Kentucky Employer Identification Number
KEWES	Kentucky Electronic Workplace for Employment Services
KRC	Kentucky Revenue Cabinet
KRS	Kentucky Revised Statutes
LAN	Local Area Network
LSA	Local Security Authority
LWIA	Local Workforce Investment Areas
MARS	Management Administrative Reporting System
MFE	Modernized Front End
NT	New Technology
N/A	Not Applicable
OMB	Office of Management and Budget
PDC	Primary Domain Controller
R & D	Research and Development
SEFA	Schedule of Expenditures of Federal Awards
SQL	Structured Query Language
UI	Unemployment Insurance
UPS	Unified Prosecutorial System
WIA	Workforce Investment Act

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SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003

CFDA # Program Title		Expenditures		Provided to Subrecipient
		Cash	Noncash	
<u>U.S. Department of Labor</u>				
Direct Program:				
17.002	Labor Force Statistics	\$	1,038,743	\$
17.203	Labor Certification for Alien Workers		301,942	
Employment Services Cluster:				
17.207	Employment Service		12,272,201	5,994
17.801	Disabled Veterans' Outreach Program (DVOP)		709,459	
17.804	Local Veterans' Employment Representative Program		747,955	
17.225	Unemployment Insurance (Note 2) (Note 3)		640,076,477	5,987
17.245	Trade Adjustment Assistance - Workers (Note 2)		18,516,129	
17.255	Workforce Investment Act (Note 2) (Note 4)		109,196	95,546
Workforce Investment Act Cluster:				
17.258	WIA Adult Program (Note 2)		13,537,375	13,414,127
17.259	WIA Youth Activities (Note 2)		14,264,083	13,273,095
17.260	WIA Dislocated Workers (Note 2) (Note 4)		19,565,986	18,111,151
17.263	Youth Opportunity Grants		47,112	24,923
17.267	WIA Incentive Grants - Section 503 Grants to States		1,410,281	800,407
NA	National Occupational Information Coordinating Committee (Note 5)			
Passed Through From Cabinet for Families and Children:				
17.253	Welfare-To-Work - Grants to States and Localities (Note 5)			
<u>U.S. Department of Education</u>				
Direct Programs:				
84.002	Adult Education - State Grant Program		9,928,456	9,461,406
84.048	Vocational Education - Basic Grants to States		12,739,187	10,921,432
84.126	Rehabilitation Services - Vocational Rehabilitation Grants to States (Note 2) (Note 5)		45,504,749	1,001,914
84.128	Rehabilitation Services - Service Projects		142,024	141,800
84.161	Rehabilitation Services - Client Assistance Program		149,661	
84.169	Independent Living - State Grants		248,504	31,575
84.177	Rehabilitation Services - Independent Living Services for Older Individuals Who are Blind		363,408	

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003

CFDA # Program Title	Expenditures		Provided to Subrecipient
	Cash	Noncash	
<u>U.S. Department of Education (continued)</u>			
Direct Programs: (continued)			
84.187 Supported Employment Services for Individuals with Severe Disabilities	431,381		
84.224 Assistive Technology	409,016		207,420
84.243 Tech - Prep Education	2,659,674		2,478,387
84.265 Rehabilitation Training - State Vocational Rehabilitation Unit In-Service Training	91,355		
84.346 Occupational and Employment Information State Grants	83,690		
<u>U.S. Department of Health and Human Services</u>			
Passed Through From Cabinet for Families and Children			
93.558 Temporary Assistance for Needy Families	2,816,207		
Passed Through From Cabinet for Health Services			
93.630 Developmental Disabilities Basic Support and Advocacy Grants	27,190		
93.958 Block Grants for Community Mental Health Services	81,665		
TOTAL CABINET FOR WORKFORCE DEVELOPMENT	\$ 798,273,106	\$	69,975,164

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003

Note 1 - Purpose of the Schedule and Significant Accounting Policies

Basis of Presentation - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*. The accompanying schedule includes all federal grant activity for the Commonwealth, except those programs administered by state universities, and is presented primarily on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. The Commonwealth elected to exclude state universities from the statewide single audit, except as part of the audit of the basic financial statements.

KRS 45.229 provides that the Finance and Administration Cabinet may, “for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose.” However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

The basic financial statements of the Commonwealth are presented on the modified accrual basis of accounting for the governmental fund financial statements and the accrual basis of accounting for the government-wide, proprietary fund, and fiduciary fund financial statements. Therefore, the schedule may not be directly traceable to the basic financial statements in all cases.

The accompanying schedule includes cash federal financial assistance programs. The Cabinet for Workforce Development (CWD) had no noncash Federal financial assistance for FY 03.

Clusters of programs are indicated in the schedule by light gray shading.

Inter-Agency Activity - Certain transactions relating to federal financial assistance may appear in the records of more than one (1) state agency. To avoid the overstatement of federal expenditures, the following policies were adopted for the presentation of the schedule:

- (a) Federal moneys may be received by a state agency and passed through to another state agency where the moneys are expended. Except for pass-throughs to state universities as discussed below, this inter-agency transfer activity is reported by the agency expending the moneys.

State agencies that pass federal funds to state universities report those amounts as expenditures.

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003

Note 1 - Purpose of the Schedule and Significant Accounting Policies (Continued)

Inter-Agency Activity (Continued)

- (b) Federal moneys received by a state agency and used to purchase goods or services from another state agency are reported in the schedule as an expenditure by the purchasing agency only.

Note 2 - Type A Programs

Type A programs for the Commonwealth mean any program for which total expenditures of federal awards exceeded \$18 million for FY 03. CWD had the following cash programs that met the Type A program definition for FY 03, some of which were administered by more than one (1) state agency. Certain component units and agencies audited by certified public accounting firms had lower dollar thresholds. The Commonwealth identified clusters among the Type A programs by gray shading. These Type A programs and clusters were:

CFDA #	Program Title	Expenditures
17.225	Unemployment Insurance	\$ 640,076,477
17.245	Trade Adjustment Assistance – Workers	18,516,129
17.255	Workforce Investment Act	109,196
Workforce Investment Act Cluster:		
17.258	WIA Adult Program	13,537,375
17.259	WIA Youth Activities	14,264,083
17.260	WIA Dislocated Workers	19,565,986
84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	45,504,749
Total Type A Programs		<u>\$ 751,573,995</u>

Note 3 - Unemployment Insurance (CFDA #17.225)

The Commonwealth paid out \$611,175,296 in benefits in FY 03. The amounts shown on the accompanying schedule reflect both the amount expended for benefits from the Trust Fund and an additional \$28,901,181 of federal funds expended for administration of the program, resulting in a combined total of \$640,076,477 in federal expenditures.

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2003

Note 4 - Workforce Investment Act (CFDA #17.255) and WIA Dislocated Workers (CFDA 17.260)

The Workforce Investment Act program (CFDA #17.255) reports total cash expenditures of \$109,196. This amount includes expenditures of \$102,574 and \$6,622 from the Job Training Partnership Act (CFDA #17.250) and CFDA #17.255, respectively. These programs were consolidated into the WIA Adult Program (CFDA #17.258) and WIA Youth Activities (CFDA #17.259) in 2001. However, the expenditures cannot be accounted for separately by the agency and, therefore, will be reported under CFDA #17.255 until fully expended.

WIA Dislocated Workers (CFDA #17.260) includes cash expenditures of \$4,074,341 from the Employment and Training Assistance – Dislocated Workers (CFDA #17.246) grant. CFDA #17.246 was consolidated into CFDA #17.260 in 2001.

Note 5 - Research and Development Expenditures

OMB Circular A-133 Section 105 states, “Research and development (R&D) means all research activities, both basic and applied, and all development activities that are performed by a non-federal entity.”

The expenditures presented in the SEFA include R&D expenditures. The R&D portion of the expenditures for each program is listed below.

CFDA #	Program Title	Expenditures
84.126	Rehabilitation Services - Vocational Rehabilitation Grants to States	\$ 61,815
	Total R&D Expenditures	<u>\$ 61,815</u>

FINANCIAL STATEMENT FINDINGS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 03-CWD-1: The Division Of Unemployment Insurance Should Perform Reconciliation Of Tax Payments Received By Kentucky Revenue Cabinet To Its Mainframe Program**

We found that Unemployment Insurance – Tax Branch had not reconciled deposits made by the Kentucky Revenue Cabinet (KRC) to the postings made in the mainframe program WFUIA42 (Program 42) on employer accounts. Furthermore, supporting documentation was not maintained to verify each deposit. No single deposit could be tied to an individual employer account to ensure that the amounts paid by the employers were actually posted to their accounts.

Unemployment Insurance employer contribution payments are received and processed through the Modernized Front End (MFE) processing by the KRC. KRC also prepares the deposit for the bank and transmits the data images from the reports and payments processed that day to the Unemployment Insurance (UI) Kentucky Electronic Workforce for Employment Services (KEWES) system to post to the employer accounts maintained on Program 42.

If employer accounts are not reconciled to the deposit to ensure proper posting, it can affect the receivable balance or deferred revenue balance.

Good internal controls should ensure all cash receipts processed via the KRC MFE process reconcile to UI agency records.

Recommendation

We recommend procedures be implemented to reconcile the deposits made by KRC to the postings on employer accounts on a timely basis.

FINANCIAL STATEMENT FINDINGS

Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance

FINDING 03-CWD-1: The Division Of Unemployment Insurance Should Perform Reconciliations Of Tax Payments Received By Kentucky Revenue Cabinet To Its Mainframe Program (Continued)

Management's Response and Corrective Action Plan

After four years of effort to be able to reconcile to Revenue and have supporting documentation there is now a daily verification process in place. The MFE upload file of reports and payments includes the "MFE_batch" number on each DLN as part of the file. The MFE_batch is a number listed on the actual deposit to the bank. This data is loaded into a table to record the deposit number for each DLN. We also receive a daily file of the deposit information containing the MFE_batch and the amount of the deposit. The MFE_upload record is matched with the deposit record by using the MFE_batch number. At this point, the actual deposit date is added to the record. The "MFE_batch" and the "deposit_date" are now part of our Oracle tables. We can query and verify deposit records. Below is an example of one of the tables used to balance.

<i>MFE_BATC</i>	<i>DEPOSIT_D</i>	<i>AMOUNT</i>	<i>CSH_DEB_</i>	<i>TOT DIFF</i>
177448	05-JAN-04	11,132.02	11,132.02	.00
177449	05-JAN-04	4,325.39	4,325.39	.00
177450	05-JAN-04	2,734.64	2,734.64	.00
177451	05-JAN-04	4,777.59	4,777.59	.00
177452	05-JAN-04	5,620.27	5,620.27	.00
177453	05-JAN-04	5,385.28	5,385.28	.00
177454	05-JAN-04	10,620.68	10,620.68	.00
177455	05-JAN-04	6,929.44	6,929.44	.00
177456	05-JAN-04	2,309.40	2,309.40	.00
177457	05-JAN-04	83,393.09	83,393.09	.00
177509	07-JAN-04	16,515.91	16,515.91	.00

FINANCIAL STATEMENT FINDINGS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 03-CWD-2: The Division Of Unemployment Insurance Should Enhance Controls To Ensure Proper Reporting Of The Closing Package**

During testing of 76 delinquent employer contribution receivables and 52 deferred revenues, we discovered 46 that had the following errors:

- Payments were received timely; however, they were not posted correctly to employer accounts or were posted to the wrong employer account on Program 42, and corrections or adjustments were not made until after June 30, 2003.
- Payments were received and not automatically applied to the outstanding balance on Program 42. This resulted in accounts receivable and accounts payable balances simultaneously for the same account at June 30, 2003.
- Wages, excess wages, and taxable wages were reported incorrectly on Program 42, which created a receivable. In some instances, journal entries were performed incorrectly or the adjustment was not posted until after June 30, 2003.
- Amended returns were posted as receivables instead of journal entries being made to correct the original return. One instance was noted where two returns were posted to the same quarter for the exact same amounts.
- Receivable or deferred revenue amounts reported at June 30, 2003 were not supported on the system when testing. The agency lacked adequate supporting documentation to explain these discrepancies.
- A payment was posted as a voluntary contribution (transaction code 30) instead of being applied to the corresponding report and created an incorrect accounts receivable.
- An account was bankrupt and the case was closed January 3, 2003; however, it had not been declared uncollectable in the system.
- Two (2) instances were found where the payment had been posted to the system, creating an accounts payable balance; however, the report was never posted.

An overstatement of receivables from delinquent employer contributions and deferred revenue on the closing package forms in the amount of \$18,208,099 and \$11,329,521, respectively was reported to FAC and was posted into the MARS system for financial statement reporting.

Proper internal control dictates that the agency should have a computer system in place to adequately maintain employer accounts to ensure that information input into the system is accurate and reliable.

Generally Accepted Accounting Principles (GAAP) dictate that government funds recognize revenues in the accounting period in which they become susceptible to accrual – both measurable and available. Therefore, amounts that are available, but not otherwise measurable, should be reported as deferred revenues rather than as a revenue.

FINANCIAL STATEMENT FINDINGS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 03-CWD-2: The Division Of Unemployment Insurance Should Enhance Controls To Ensure Proper Reporting Of The Closing Package (Continued)**

Recommendation

During testing this year, we noted areas of improvement from the prior year audit. However, there are several areas that still need to be addressed. Computer system and staff controls should be enhanced to ensure proper reporting of the closing package forms for Financial Statement purposes. Corrections to computer systems and additional system controls must be implemented to prevent the reoccurrence of errors that affect the employer accounts.

Management's Response and Corrective Action Plan

- *We will respond to each type of error identified individually.*
- *Erroneous posting of payments is one of the conditions we attempted to identify and correct in our report audit process. We are making efforts to ensure that the audit process is completed in a timely fashion so that corrections and adjustments can be completed prior to the closing package. At this time we have not identified any additional edits or process steps that would reduce this occurrence, and are focusing efforts on the timeliness and accuracy of the existing correction process. We have established an on-going training course for staff involved in the report audit process to accomplish this.*
- *We have developed a computer edit to identify instances where payments that should have been automatically applied to an existing receivable in order to research the reasons for the occurrences and develop solutions. We will address human error through training, incorporating appropriate corrective action in the training initiative referenced above. Where programming "bugs" are identified we will request that GOT correct the problem as a priority.*
- *We have changed the report audit process to require staff to review every instance where a receivable is created for a report, which will allow us to identify and correct these data capture errors. The finding of erroneous journal entries is being addressed through additional staff training; we are also considering greater restrictions on the staff authorized to make journal entries as a further quality control measure. The finding relating to timeliness of adjustments has been addressed in our answer to the first finding, above.*

FINANCIAL STATEMENT FINDINGS***Reportable Conditions Relating to Internal Controls and/or
Reportable Instances of Noncompliance*****FINDING 03-CWD-2: The Division Of Unemployment Insurance Should Enhance Controls To Ensure Proper Reporting Of The Closing Package (Continued)**

Management's Response and Corrective Action Plan (Continued)

- *Instances of either amended or duplicate reports posted to the accounting system are automatically identified in our report audit process, and as noted above we believe the solution is not additional edits but a more timely completion of the quarterly audit. We are also considering eliminating the mailing of report forms to employers who file electronically, since a primary reason for duplicate entries is employers who file both an electronic and a paper form.*
- *We are retaining the reports that document changes. During our remodeling these reports were not retained. We have also requested programming so this documentation is retained within the program and can be queried by KEIN.*
- *This finding was limited to a single incident, and we believe it was a result of human error. The process for identifying and posting voluntary contributions as distinct from regular employer payments will be reviewed with all staff responsible for these transactions.*
- *We have implemented new delinquent account management tools as a part of our KEWES process reengineering, including a more efficient method of identifying potential uncollectible accounts. We believe this will address the timeliness issue in future.*
- *This occurs most frequently when the report is filed electronically. We are investigating a solution that would hold and match payment and report data for electronic filers in KEWES before the data are submitted to the mainframe, to more efficiently identify such instances where a payment is missing the corresponding report. Meanwhile, this condition can be identified and corrected when delinquent report assignments are issued. To the extent that we complete the report audit cycle in a more timely fashion, as discussed above, we would expect to make these assignments sooner and thus find and correct instances of missing reports.*

FINANCIAL STATEMENT FINDINGS

Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance

FINDING 03-CWD-3: The Cabinet For Workforce Development Should Strengthen The Security Of Administrator Accounts

Vulnerability testing of CWD machines revealed several instances of lax security over Administrator accounts, resulting in the potential of machines being vulnerable to intrusion. These instances vary in severity, but illustrate that the CWD local area network was vulnerable during FY 2003.

We examined two (2) CWD machines that provided NetBIOS information during the current year's review. Additionally, four (4) machines that have provided NetBIOS information since FY 02 were reviewed as a follow-up procedure. Administrator accounts on five (5) of the machines had not been renamed or disabled. Each machine had administrator accounts that have never been logged into. Since the administrator cannot be locked out, if the account is not renamed, the machine could be vulnerable if a potential intruder attempted to gain access by guessing the administrator password through a brute force attack.

Administrator accounts are very powerful and can allow full access to the system. Therefore, these accounts should be scrutinized to ensure they are adequately secured. At a minimum, the account passwords for these accounts should be changed from the system defaults. Further, some Administrator accounts can be renamed to help obscure them from an unauthorized user's view.

Recommendation

We recommend that CWD review all machines to ensure that the local administrator accounts have been changed from the default naming conventions and require the use of a password. Further, all applications that might allow a user access to the system or to configuration settings should be reviewed to ensure that default logons are not allowed.

Management's Response and Corrective Action Plan

*We are continuing to audit our servers for accounts that are unnecessary or need to be renamed. Most of the Administrator accounts have been changed from the default name and require the use of a secured password. Additionally, by making changes to the local security policies and registry settings we will reduce or eliminate the types of responses our machines provide. We are constantly reviewing different applications that might inadvertently allow a user access to our systems or permit access to configuration settings to ensure that appropriate changes have been made to **not** allow default logons.*

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 03-CWD-4: The Division Of Unemployment Insurance Should Strengthen Controls Over The Preparation Of Accounting Estimates**

The allowance for uncollectible accounts for benefit overpayment receivables reported on the AFR-30 and AFR-32 closing package forms for fund 6200 was not re-evaluated. The Department for Unemployment Insurance currently bases the estimate on 11% of overpayments 15 months and older. According to agency personnel, the determination to base the estimate at 11% of overpayments 15 months and older was established over eight years ago and the rationale is unknown. The amount reported on the closing package was \$869,192. The actual write-offs of uncollectible accounts for FY 2003 per the journal entry report used to report on the ETA 227 was \$1,032,389. The amount reported on the closing package for FY 03 is a reasonable estimate; therefore, no adjustment was recommended. However, it was noted that the total amount of write-offs did not include interest or penalties.

When the allowance for uncollectible accounts is not evaluated to determine if it is reasonable, the net receivable balance can be misconstrued for financial reporting. Also, excluding interest and penalties from the calculation could overstate or understate the financial statements.

Proper accounting procedures dictate the estimate for allowance for uncollectible accounts be based on historical information and should be reasonable for future activity.

Recommendation

The agency should establish a procedure to estimate a reasonable allowance for uncollectible accounts and document their methodology. The agency should consider historical data per the journal entry reports. It may be necessary to modify the report to include interest and penalties associated with each account.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 03-CWD-4: The Division Of Unemployment Insurance Should Strengthen Controls Over The Preparation Of Accounting Estimates (Continued)

Management's Response and Corrective Action Plan

During July of this past year we did reevaluate the estimate for the allowance of uncollectable accounts for benefit overpayments. We used the past four years to do this calculation.

<i>Total Benefit Overpayments Over 15 months</i>		<i>Total Actual Writeoffs</i>	<i>Estimate</i>
1999	7,740,646.62	239,969.00	851,471.13
2000	7,449,541.59	1,434,226.00	819,449.57
2001	7,606,400.03	770,498.00	836,704.00
2002	7,399,270.54	925,013.00	813,919.76
30,195,858.78		3,369,706.00	
Average Written Off Each Year		11.2%	
2003 Estimate		11%	

We believe that 11% is still accurate. We will continue to do this estimate each year and will adjust accordingly when needed.

The amount we report for benefit overpayments receivable does not include penalties and interest. It only includes the principal amount due. The amounts written off include penalties and interest.

Auditor's Reply

Management over CWD Benefit's Branch did not adequately communicate how calculation of the estimate for the allowance of uncollectable accounts was derived to the agency person responsible for preparation of the closing package. In the prior year audit, it was recommended that the agency reevaluate the calculation and be able to provide documentation to support the 11% estimate. During the course of the current CWD audit, auditors followed up on the prior verbal comment and were, once again, given no supporting documentation to determine reasonableness of the estimate; hence, testing was unable to be performed in FY 03, which resulted in a formal finding. Management's response included the reevaluated calculation to support the 11% estimate; however, all fieldwork had been completed and the support could not be tested for accuracy or reliability. Now given the submitted data in this finding, we trust that the closing package preparer will have updated data for the preparation of the estimate and that it will be made available to the auditors for follow-up in FY 04.

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 03-CWD-5: The Division Of Unemployment Insurance Should Implement Controls To Ensure That All Transactions Have Proper Authorization And Adequate Documentation**

During the course of the audit, the auditor noted several instances where there was lack of supporting documentation for transactions to employer accounts. The lack of support related to both the refund procedures and adjustments made to employer accounts.

These adjustments were in the form of journal entries to employer accounts within the UI Program 42 system. There was no form of supporting documentation or explanation on the actual entry in the comment section. Some journal entries were erroneously created without proper review or approval. Therefore, additional journal entries had to be made to correct these transactions.

The lack of support with regards to the refund procedures could have been a missing amended report, authorized request for a refund, or other support to show that this transaction was valid.

Duplication occurs when proper review and approval have not been utilized. Unsupported transactions can result in errors and misstatements that could lead to either an inappropriate refund or charge to an account. This also could result in a misstatement in the financial statements.

Good internal control dictate that all transactions be properly supported and documented to ensure accuracy, completeness, and validity. All transactions should be reviewed and the documentation should be maintained. Proper review and approval procedures eliminate erroneous or duplicate transactions.

Recommendation

We recommend all transactions performed on an employer account be well supported and a proper explanation for the adjustment documented in the comment section of the entry, as well as utilizing Program 45 for comments. All transactions should also be properly reviewed for accuracy to prevent numerous corrections to employer accounts. These transactions should also follow through the proper lines of authority to prevent any unauthorized or invalid entries. The agency also needs to set up certain lines of authority for such transactions to prevent these entries from being created by everyone, especially new and inexperienced personnel.

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 03-CWD-5: The Division Of Unemployment Insurance Should Implement Controls To Ensure That All Transactions Have Proper Authorization And Adequate Documentation (Continued)**

Management's Response and Corrective Action Plan

We are implementing several different processes to provide better explanations and supporting documentation for journal entries and refunds.

We have established an on-going training course. This training course is set up in the live environment working through the queue. As part of this instruction we are reinforcing to employees the need to fully explain an adjustment by journal in the comment section and send all supporting documentation to the Technical Services Branch to be imaged.

Journals that do not pass edits or that are in error will go to the queue. The employee will review the journal and program 42 to determine what needs to be corrected and why then submit the journal to correct. However, an employee can accept as is but an error is generated. This error will show on the daily report received by the batch audit supervisor as out of balance and will have to be corrected

Monthly reports are maintained that shows all deleted and added journal entries to an account. The programmers are working on an electronic version of this.

Effective November 2003 refund letters received without signatures are being returned to employers requesting a signature. We have supporting request for all refunds, except there may be a few without a signature. The manager reviews all refunds prior to the MARS entry. Refunds are not approved if the company owes money or the refund is not valid. Exception to the rule, is the vendor offset received in error

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 03-CWD-6: The Cabinet For Workforce Development Should Ensure That Security Information Leakage Concerning Agency Devices Is Minimized

As in the prior year's review, CWD did not restrict critical information divulged by its network machines. During the examination of the CWD local area networks (LANs) security for FY 2003, we discovered several instances where computers within the LANs provided information that could potentially help an intruder with developing details for an attack.

Using standard scanning tools, we reviewed the names and other remarks for all machines located within two (2) domains of the CWD. We noted that the naming convention for several machines was not sufficiently ambiguous to disguise the function of some machines. Further, there were remarks for several that might catch an intruder's interest.

We also ran other vulnerability assessment tools on 36 machines within the two (2) CWD domains to determine if they would return information on Local Security Authority (LSA), Password Policies, or Valid User, Group, or Share Lists. The following table depicts the number of machines that would provide this information.

Type of Information	Number of Machines Returning Information	Percent of 36 machines
LSA	21	58.3%
Password Policies	8	22.2%
Valid User Lists	7	19.4%
Valid Group Lists	8	22.2%
Valid Share Lists	9	25.0%

Though these percentages reflect a decrease from the FY 2002 review, the following depicts a summary of machines that have provided information since our FY 2002 review.

LSA

Ten (10) machines noted within the FY 2002 review continue to provide LSA information.

Password Policies

Six (6) machines noted within the FY 2002 review continue to provide Password Policies.

Valid User Lists

Six (6) machines noted within the FY 2002 review continue to provide Valid User Lists.

Valid Group Lists

Six (6) machines noted within the FY 2002 review continue to provide Valid Group Lists.

Valid Share Lists

Six (6) machines noted within the FY 2002 review continue to provide Valid Share Lists.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 03-CWD-6: The Cabinet For Workforce Development Should Ensure That Security Information Leakage Concerning Agency Devices Is Minimized (Continued)

Finally, we found two (2) machines with port 2301 open. We were allowed to log on to the Compaq Insight Manager (CIM) application on both of these machines anonymously and with the default 'administrator,' 'operator,' and 'user' userid and password. This is the second year this issue has been noted for one of the machines. This access provides too much information to a potentially unauthorized individual.

An agency's domain information that is accessible to the world at large through inquiry tools or default logons should be kept at a minimum. Agencies should ensure that information such as location, accounts associated with the machine, data residing on the machine, and the machine's role is not divulged or is stated in the most minimal of terms. To accomplish this, an agency can set devices to not respond to certain types of inquiries, can use naming conventions that obscure the purpose of machines, can provide no comments on machine activity, and can restrict access to default logons for applications.

Recommendation

We recommend that CWD restrict the information that is being provided by its LAN machines to anonymous users. First, the naming convention for machines should be altered to make them more ambiguous and any unnecessary comments associated with the machines should be removed. Second, boundaries should be placed on what types of responses machines provide based on certain inquiries. Third, the default logons for the CIM application should be changed.

Management's Response and Corrective Action Plan

We have recommended that management change to a more secure naming convention for our machines. We expect this process to take time due to the number of machines in the cabinet and the fact that certain applications may access some machines based on the machine name. Therefore we need time to evaluate all the ramifications before instituting a more secure naming convention policy. We will be removing comments associated with our machines which provide information such as location, accounts associated with the machine, type of data that resides on the machine and/or the machine's role. Also, by making changes to the local security policies and registry settings we will reduce or eliminate the types of responses our machines provide. Compaq Insight Manager has been removed or will be removed from all our machines.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 03-CWD-7: The Cabinet For Workforce Development Should Ensure That All Open Ports On Agency Machines Have A Business-Related Purpose

During the interim security vulnerability assessment testing for machines controlled by CWD, we found several CWD machines with ports open that may not have a specific, business-related purpose. Due to the large number of issues, the findings are grouped below by port number and application.

Port 21

One (1) machine was found with port 21 open. This machine allowed the auditor to create FTP session through Internet Explorer with an anonymous login. Further, this session allowed access to an executable.

Port 99

For the second year, the same machine was found with port 99 open. This port can be used for several serious exploitations, such as altering file associations, Trojan horse attacks, or introduction of a backdoor program that can be used to compromise the system.

Port 1033

Two (2) machines were found with port 1033 open. This port potentially allows unauthorized access to the operating system with generic login and passwords.

Port 6667

For the second year, the same two (2) machines were found with port 6667 open. This port potentially allows unauthorized access to the operating system with generic login and passwords. Further, it is susceptible to the BLA Trojan that gains remote access in attempt to steal passwords.

The existence of open ports is an invitation for intruders to enter your system. To minimize the risk of unauthorized access to a computer, only necessary, business-related ports should be open, and all applications residing at these ports should be secured to the extent possible.

Recommendation

We recommend that CWD perform a review of all open ports on the servers discussed in this comment. If there is not a specific, business-related purpose requiring a port to be open, then that port should be closed. If a port is found to have a business-related purpose, the CWD should ensure all application default username and password combinations are changed. Further, we recommend that CWD begin a periodic review of open ports on all machines owned by the agency to ensure necessity.

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 03-CWD-7: The Cabinet For Workforce Development Should Ensure That All Open Ports On Agency Machines Have A Business-Related Purpose (Continued)****Management's Response and Corrective Action Plan**

*We have checked the majority of our machines and closed all ports that do **not** have a business-related purpose or pose high-risk threats and/or have documented vulnerabilities. Additionally, we regularly scan all of the machines in our domain to identify all open ports. Any open ports found, which do **not** have a business-related purpose are closed immediately and those that **do** have a business-related purpose are to have the strongest possible security settings applied. Your report notes that port 6667 is open on several machines. This has been identified in previous audit reports and responded to by CWD. This port is being used by Powerchute (UPS software) and has a business-related purpose. Your report also mentions 2 machines with port 1033 open. We performed several scans on these machines and were unable to find this port open, so we are not sure at this point what application was using this port but will continue to scan and resolve when found. Your report notes that port 21 is open on 2 machines. The FTP services have been removed from one of these machines but still remains on one, which is used to update McAfee on CWD machines.*

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 03-CWD-8: The Cabinet For Workforce Development Should Ensure All User Accounts On Its Agency Machines Are Necessary

While performing interim vulnerability tests of CWD, we found several instances where it appears unnecessary accounts were established on servers or for applications.

We sought NetBios information from 36 machines within two (2) CWD domains, including the Primary Domain Controllers (PDC), Backup Domain Controllers (BDC), SQL machines, and NT machines for the current year's review. NetBios account information was obtained from two (2) of those machines. Additionally, 22 machines were reviewed as a follow-up procedure for the issues noted during the FY 2002 vulnerability test. NetBIOS account information was obtained from four (4) of those machines. All machines providing information fell within one (1) domain. We examined this information to search for default accounts, days since password change, and disabled or unused user accounts. There were numerous accounts that had been disabled, whose password age were over the standard 30 days or had never logged onto the system, including guest accounts; two are default accounts that have not been renamed.

Intruders often use inactive accounts to break into a network. If a user account has not been used for a period of time, the account should be disabled until it is needed. This minimizes the possibility that an unauthorized user will use the account. An account should be deleted if it is not going to be reinstated. All account passwords should be changed in a manner that complies with the agency's password policy of 30 days. Further, guest accounts in operating system and applications are one of the first accounts that an intruder will attempt to use. Therefore, if possible they should be renamed or removed immediately after installation.

Recommendation

We recommend that CWD review accounts on all servers to determine which accounts had no password change within the last 30 days. These accounts should be evaluated to determine if they are still valid accounts required for a business-related purpose. If not, the accounts should be disabled or deleted as appropriate. Further, where possible, all guest accounts should be renamed or removed.

Management's Response and Corrective Action Plan

The Cabinet for Workforce Development has been reviewing accounts on all stand-alone servers, domain controllers and local machines. The accounts that have had no password changed within the last 31 days, have been disabled or have not been used for more than 60 days are being evaluated to determine if they are still valid accounts required for a business-related purpose. If not, the accounts will be disabled, deleted or renamed as appropriate. We noticed in your report that you recommend all passwords should be changed every 30 days. However, we have set our policy to meet the GOT requirements of every 31 days as stated in the following GOT policy: UserID_and_Password_Policy,_CIO-072.doc.

FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Instances of Noncompliance

FINDING 03-CWD-9: The Cabinet For Workforce Development Password Policy Should Be Consistently Applied To All Local Area Network Machines

As was noted in the prior two (2) audits, password policies established on certain critical CWD machines did not adhere to the agency password policies. During the FY 2003 audit, we attempted to obtain the password policies of all PDC, Structured Query Language (SQL), and a sample of BDC and Network (NT) machines maintained by CWD using a vulnerability assessment tool. The auditor obtained password policies for nine (9) machines.

It was found that the password policies established on these machines did not comply with the standards set forth by the Governor's Office of Technology (GOT) (the policy followed by the CWD). See table below for findings.

Security Measure	GOT Standards	Number of machines not in compliance with policy
Maximum Age	30 days	5 – 42 days
Minimum Age	1 day	9 – None
Minimum Length	8 characters	5 – None
Lockout Threshold	3 attempts	9 – None

The NetBIOS information was examined to determine if accounts adhered to the Policy. We found user, guest, and administrator accounts on six (6) machines, which had logged onto the system, but did not comply with the standard to change an account password at least every 30 days. Four (4) of these machines were noted as having the same issue during the FY 2002 review.

Currently, CWD has a security policy that is in draft form. This policy briefly describes password policies; however, is not complete and has not been issued to the agency at large.

Passwords are a significant feature to guard against unauthorized system access. The failure to follow adequate password policy standards when establishing a system password could ultimately compromise the entire network. The purpose of a password policy is to establish a standard to create strong passwords, to protect those passwords, and to ensure passwords are changed within a specified time period. To assist in the security of a network, it is necessary for a strong policy to be developed and consistently implemented on all machines throughout the network.

Recommendation

We recommend that CWD review all servers within their agency-owned domains to ensure that the password policy established complies with the policy guidelines recommended by either GOT or industry standard, and that all user accounts comply with those established policies. Further, CWD should review its security policy to ensure that the established password policies are included. Efforts should also be made to ensure the security policy is finalized and issued to all employees.

FINANCIAL STATEMENT FINDINGS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 03-CWD-9: The Cabinet For Workforce Development Password Policy Should Be Consistently Applied To All Local Area Network Machines (Continued)****Management's Response and Corrective Action Plan**

We have renamed the Administrator account and changed the password on the majority of our servers. We have set our user passwords to change every 31 days. We have begun to review all of our security policies in which the password policy is included. Efforts are also being made to ensure that all security policies are finalized and issued to all employees. CWD will continue to review all machines and user accounts within our agency-owned domains to ensure that all security policies including the password policy are complied with and enforced. We will continue to comply with the policy guidelines set by GOT and/or follow the recommended industry standards. We noticed in your report that you recommend all passwords should be changed every 30 days. However, we have set our policy to meet the GOT requirements of every 31 days as stated in the following GOT policy: UserID_and_Password_Policy,_CIO-072.doc

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 03-CWD-10: The Department For Training And ReEmployment Should Implement Controls Over Monitoring Procedures to Ensure Compliance**

State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.255 – Workforce Investment Act Cluster

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

During the FY 2003 audit, we tested the audit log maintained by the Department for Training and ReEmployment (DTR) to track subrecipient monitoring related to the required audits of subrecipients. During this review, the auditor noted the following:

- DTR did not obtain subrecipient audit reports in a timely manner to comply with federal regulations.
- DTR did not resolve subrecipient audit findings timely. Two (2) subrecipient audit reports contained findings related to the Workforce Investment Act (WIA) program, which have yet to be fully resolved. Furthermore, the eligibility finding for Lake Cumberland Area Development District (ADD) initially occurred in the FY 2001 audit. Lake Cumberland ADD submitted a corrective action plan in December 2003; however, questioned costs related to the finding have not been resolved. DTR also failed to issue an initial determination upon receipt of the corrective action plan from Bluegrass ADD. DTR has not followed up on the corrective action plan to resolve the findings. The final determination reported no findings or questioned costs for either ADD.
- Agency records were not reconciled to the subrecipients' audited financial statements for several Local Workforce Investment Areas (LWIA). Amended DTR-38s (Quarterly Cash Reconciliations) were submitted to agree to the audited financial statements. However, there was no support or explanation for the adjustments.

These findings relate to the local area FY 2002 OMB Circular A-133 audits; however, DTR has made improvements related to future audits.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 03-CWD-10: The Department For Training And ReEmployment Should Implement Controls Over Monitoring Procedures to Ensure Compliance (Continued)**

- The receipt of the audit reports in an untimely manner delays the entire resolution process. It also increases the likelihood that subrecipient weaknesses noted in the audit continue for longer periods of time since they are not being addressed.
- When reports submitted to grantors are not reconciled, it can lead to the potential for federal reporting that does not agree to the financial statements on which an opinion has been given.

According to OMB A-133, the funding agency should be sent a copy of the audit report within the *earlier* of 30 days after [the subrecipient's] receipt of the auditor's report(s), or nine (9) months after the end of the audit period. This requirement is also outlined in DTR's Audit Resolution Guide. This requirement is in effect for fiscal years beginning after June 30, 1998. [OMB Circular A-133 Subpart C, Sec. 320 (a)]

The WIA regulations state: "The Governor is responsible for resolving findings that arise from the State's monitoring reviews, investigations and audits (including OMB Circular A-133 audits) of subrecipients." [20 CFR 667.500 (a) (1)]

Further, according to OMB A-133, pass-through entities are responsible for making the management decision on audit findings of subrecipients within six (6) months after receipt of the audit report. Corrective action should also be initiated within six (6) months after receipt of the audit report. [OMB Circular A-133 Subpart D Sec .400 (d)(5)]

Recommendation

DTR should continue to improve monitoring procedures to ensure compliance with WIA regulations, OMB Circular A-133, and DTR guidelines regarding audit resolutions of subrecipients.

We recommend that DTR implement procedures to ensure timely management decisions on audit and monitoring findings and require subrecipients to initiate corrective action on deficiencies identified in audits and subrecipient monitoring within six (6) months after receipt of the audit report.

We also recommend that agency records be reconciled to the audited financial statements. All supporting documentation should be maintained for any differences, such as auditor adjustments, accrued revenue, accrued expenses, etc.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 03-CWD-10: The Department For Training And ReEmployment Should
Implement Controls Over Monitoring Procedures to Ensure Compliance (Continued)****Management's Response and Corrective Action Plan**

DTR agrees with this finding and will implement procedures to ensure timely management decisions on audit and monitoring findings, and require subrecipients to initiate corrective action on deficiencies identified in audits and subrecipient monitoring within six months after receipt of audit reports in future periods.

DTR will immediately initiate our audit finding resolution process for the Lake Cumberland ADD and Bluegrass ADD audits for FY 2002 and continue to follow-up on the Lake Cumberland ADD's resolution efforts of the eligibility issue finding disclosed in their FY 2001 audit.

DTR also agrees to reconcile agency records to the audited financial statements and maintain supporting documentation for any differences such as auditor adjustments, accrued revenue, accrued expenses, etc.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 03-CWD-11: The Department For Training And ReEmployment Should Implement Formal Procedures to Ensure Accurate Federal Reporting**

State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.255 – Workforce Investment Act Cluster

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

The U.S. Department of Labor (DOL) required a closeout certification for the WIA expenditures carried forward from the Job Training Partnership Act (JTPA) to be submitted by March 2003. The WIA Financial Status Reports for Program Year 1998 and 1999 were not properly supported. The total expenditures reported for each program year do not agree to the total funds carried forward from the JTPA program as certified to DOL.

We were able to reconcile federal reports to MARS for grants reported the quarter ending March 31, 2003 and after. However, there were expenditures reported in MARS that lacked a reporting category or activity code and expenditures that were miscoded; therefore, the funding source could not be properly identified.

DTR has not developed written procedures for the preparation, review, and approval of federal reports. As a result, it is difficult for someone other than the preparer to recreate the amounts reported.

- Without supporting documentation, DOL could be unable to determine if WIA transition funds were properly closed out.
- When there are numerous accounts, it can result in miscoded expenditures that may not be reported correctly. Also, it can result in inconsistent categorization of expenditures for grant reporting purposes.
- When written procedures are not in place, it can result in federal reporting is not consistent or easy to follow. When federal reports are not reviewed, errors can go undetected and uncorrected before submission.

Proper internal controls dictate that accurate and reliable information be maintained after preparing and transmitting federal reports. Reports should be adequately supported with valid and accurate documentation.

A complete policies and procedures manual will provide a structure for preparing federal reports and enable someone to review the reports for accuracy.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Reportable Conditions Relating to Internal Control and/or
Reportable Instances of Noncompliance*****FINDING 03-CWD-11: The Department For Training And ReEmployment Should
Implement Formal Procedures to Ensure Accurate Federal Reporting (Continued)**

Recommendation

We recommend DTR continue to improve the federal reporting process. Proper supporting documentation should be maintained with all federal reports and reconciled to MARS quarterly to ensure accuracy. We recommend the agency fully utilize the capabilities of MARS for tracking expenditures for each funding stream and develop internal controls to prevent miscoding of expenditures. We also recommend DTR develop written procedures for the preparation, review, and approval of federal reports.

Management's Response and Corrective Action Plan

Although DTR has implemented many improvements in the utilization of MARS to support the federal financial reports we agree that implementing the recommendations mentioned above would further improve our processes. DTR will develop and implement written procedures for the preparation, review, and approval of federal reports beginning with the period ending March 31, 2004. DTR will develop and implement internal controls to prevent miscoding of expenditures. DTR will ensure that adequate supporting documentation for federal reports is maintained and reconciled to MARS on a quarterly basis to ensure accuracy.

FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Other Matters Relating to Internal Controls and/or Instances of Noncompliance*****FINDING 03-CWD-12: The Division Of Unemployment Insurance Should Implement Procedures To Ensure Timely Submission Of The Internal Revenue Service 940 Federal Unemployment Tax Administration Certification**

State Agency: Cabinet For Workforce Development

Federal Program: CFDA 17.225 – Unemployment Insurance

Federal Agency: U.S. Department of Labor

Pass-Through Agency: Not Applicable

Compliance Area: Special Test and Provisions

Amount of Questioned Costs: None

During the audit of the Internal Revenue Service (IRS) 940 Federal Unemployment Tax Administration (FUTA) Match/Certification, we discovered that the submission date was approximately three (3) months past the actual January 31 deadline. This has been a continuing issue for the past few years; however, the auditor noted that several improvements had been made to the processing of this information and that the lateness of this report was not as severe as it has been in the past. The reason for the late submission was due to the agency having problems reconciling trial balance to agency ledgers. The agency achieved this process in April 2003 and this should be a step toward submitting the report on time for the FY 04 audit

An untimely report submission can affect the taxpayer's ability to take advantage of the FUTA tax credit. Also, untimely reporting can have an adverse reaction because of delays in taxpayers receiving notices of proposed tax increases/decreases, any refunds for decreases, or tax bills.

The IRS Document 6851 outlines the deadlines for the preparation of this certification. The deadline for this report is January 31, and it states that it is critical that this be met. 26CFR31.3302(a)-3(a), requires the state to provide this annually.

Recommendation

We recommend that UI continue to strive for timely submission of reports. We recommend that the UI continue to make improvements in the reconciliation process to prevent late report submissions.

Management's Response and Corrective Action Plan

The Federal Certification should be timely and accurate for employers not to receive notices of proposed tax increases. We have worked diligently toward correcting errors and the timeliness of the report. We completed it on February 27 of this year. In the future, with the corrections made this year, the report should be timely.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2003

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 01	01-CWD-2	The Division Of Unemployment Insurance Allowance For Uncollectable Accounts Was Not Updated For Current Year Actions	NA	0	Resolved during FY 03.
FY 02	02-CWD-1	The Division Of Unemployment Insurance Is Not Reviewing Accounts and Declaring Them Uncollectable	NA	0	Resolved during FY 03.
FY 01	01-CWD-10	The Division Of Unemployment Insurance Is Not Reconciling Accounts Receivable To Ensure Federal Reports Are Accurate	17.225	0	Resolved during FY 03.
FY 02	02-CWD-13	The Division Of Unemployment Insurance Should Ensure Federal Reports Are Supported By Accurate And Reliable Data	17.225	0	Resolved during FY 03.
FY 01	01-CWD-11	The Division Of Unemployment Insurance Has Not Performed The 1999 Certification Of Employer Contributions	17.225	0	Resolved during FY 03.
FY 02	02-CWD-14	The Division Of Unemployment Insurance Should Implement Procedures To Ensure The Accuracy And Timeliness Of The IRS 940 Federal Unemployment Tax Administration Certification	17.225	0	Resolved during FY 03.
FY 02	02-CWD-3	The Cabinet For Workforce Development Should Strengthen Controls Over Estimation Of Accounts Payable	N/A	0	Resolved during FY 03.
FY 02	02-CWD-11	The Department For Training And ReEmployment Did Not Reconcile Subrecipient Expenditures To MARS	17.255 17.258 17.259 17.260	0	Resolved during FY 03.
Total Questioned Costs				0	

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2003

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
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Reportable Conditions (Continued)

(2) Audit findings not corrected or partially corrected:

FY 01	01-CWD-3	The Cabinet For Workforce Development Should Improve Local Area Network Server Security And Consistently Apply Policies To All Servers	NA	0	See 03-CWD-3.
FY 02	02-CWD-4	The Cabinet For Workforce Development Should Strengthen The Security Of Administrator Accounts	N/A	0	See 03-CWD-3.
FY 02	02-CWD-12	The Department For Training And ReEmployment Should Implement Additional Procedures To Ensure Subrecipient Findings Are Followed Up On In A Timely Manner	17.255 17.258 17.259 17.260	0	See 03-CWD-10.

(3) Corrective action taken is significantly different from corrective action previously reported:

There were no findings to report in this category.

(4) Audit finding no longer valid or does not warrant further action:

There were no findings to report in this category.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2003

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
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Material Weaknesses/Noncompliances

(1) Audit findings that have been fully corrected:

FY 99	99-CWD-30	The Division of Unemployment Insurance Should Ensure Computer Accounting Systems Are Operating Effectively And Amounts Reported From Those Systems Can Be Supported	N/A	0	Resolved during FY 03.
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(2) Audit findings not corrected or partially corrected:

FY 02	02-CWD-2	The Division Of Unemployment Insurance Should Have A Computer System In Place To Adequately Maintain Employer Accounts	N/A	0	Due to improvements, this finding is downgraded to a reportable condition for FY 03.
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See 03-CWD-2.

(3) Corrective action taken is significantly different from corrective action previously reported:

There were no findings to report in this category.

(4) Audit finding no longer valid:

There were no findings to report in this category.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2003

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Other Matters</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 98	98-WFDC-9	The Cabinet For Workforce Development Should Properly Review Federal Reports And Supporting Documentation For Accuracy (ETA 581)	17.225	0	Resolved during FY 03.
FY 02	02-CWD-9	The Cabinet For Workforce Development Should Remove The Simple Network Management Protocol Service Or Change The Default Community String	N/A	0	Resolved during FY 03.
FY 02	02-CWD-10	The Cabinet For Workforce Development Should Strengthen The Logical Security Procedures For The Kentucky Electronic Workplace For Employment Services	N/A	0	Resolved during FY 03.
FY 02	02-CWD-15	The Department For Training And ReEmployment Should Ensure that Accurate Project Codes Are Being Utilized When Preparing Timesheets	17.255 17.258 17.259 17.260	0	Resolved during FY 03.
FY 02	02-CWD-16	The Department For Training And ReEmployment Should Implement Procedures To Ensure Subrecipient Monitoring Reports Are Issued Within A Timely Manner.	17.255 17.258 17.259 17.260	0	Resolved during FY 03.
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 02	02-CWD-5	The Cabinet For Workforce Development Should Ensure All User Accounts On Its Agency Servers Are Necessary	N/A	0	See 03-CWD-8.
FY 02	02-CWD-6	The Cabinet For Workforce Development Should Ensure That Security Information Leakage Concerning Agency Devices Is Minimized	N/A	0	See 03-CWD-6.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2003

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
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Other Matters

(2) Audit findings not corrected or partially corrected (Continued):

FY 02	02-CWD-7	The Cabinet For Workforce Development Should Ensure That All Open Ports On Agency Servers Have A Business-Related Purpose	N/A	0	See 03-CWD-7.
FY 02	02-CWD-8	The Cabinet For Workforce Development Password Policy Should Be Consistently Applied To All Local Area Network Servers	N/A	0	See 03-CWD-9.

(3) Corrective action taken is significantly different from corrective action previously reported:

There were no findings to report in this category.

(4) Audit finding no longer valid:

There were no findings to report in this category.

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